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The Legal Framework for Private Sector Activity in the Czech and Slovak Federal Republic

Cheryl W. Gray

In the reform of company, contract, and antimonopoly law, the Czech and Slovak Federal Republic could to some extent be a model for other reforming socialist economies. In constitutional and real property law, it lags behind some neighboring countries. And the courts are relatively ill-prepared to handle the skyrocketing demands expected in the newly reformed system.

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This paper — a product of the Transition and Macro-Adjustment Division, Country Economics Department — is part of a larger research effort on the economic implications of legal reform in Central and Eastern Europe. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Maxine Berg, room N11-021, extension 36969 (November 1992, 25 pages).

Since its "velvet" revolution in late 1989, the Czech and Slovak Federal Republic (CSFR) has moved steadily to create the conditions for developing a private market economy. Not only has the CSFR freed up the conditions for entry of new private firms, but it has also taken far-reaching steps to return property to former owners and to privatize large parts of its state-owned industry. For this emerging private sector to thrive, there must be a clear legal framework to provide decentralized "rules of the game."

Gray describes the evolving legal framework in the CSFR in several key areas: property, contracts, company law, foreign investment, bankruptcy, and antimonopoly law. Essentially the same legal framework exists in the Czech and Slovak republics, although the legal frameworks of the two could diverge considerably in the coming months and years if the country separates, as is expected.

The CSFR differs somewhat from its Central and Eastern European neighbors, especially Poland and Hungary, in that its pre-war legal system was more thoroughly abrogated during the socialist period. So, fewer people are familiar with market-oriented legal principles and practices. On the other hand, in 1989 the CSFR had the advantage of starting with a relatively "clean slate" on which to craft modern laws. In some areas of law — such as company, contract, and antimonopoly law — legal reform in the CSFR is relatively well-advanced and could to some degree serve as a model for other reforming socialist economies. In others — including constitutional and real property law — legal reform is embroiled in political controversy and is lagging behind developments in some neighboring countries. The interests of former property owners are clashing with those of current tenants, creating a surge of new disputes entering the courts. The surge in cases is likely to be exacerbated as the current moratorium on bankruptcy claims against state enterprises expires in 1993, and as cases under the new intellectual property laws and commercial code come onstream. The CSFR's judicial system, suffering from recent purges of judges compromised by the former regime as well as generally low pay and prestige, appears to be relatively ill-prepared to cope with the skyrocketing demands expected in the newly reformed system.

All in all, it is a time of great progress, great confusion, and great challenge.

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The Legal Framework for Private Sector Activity in the Czech and Slovak Federal Republic

Since its "velvet" revolution in late 1989, the Czech and Slovak Federal Republic (CSFR) has moved steadily to create the conditions for the development of a private market economy. Not only has it freed up the conditions for entry of new private firms, but it has also taken innovative steps to privatize large parts of its state-owned industry. For this emerging private sector to thrive, there must be a clear legal framework to provide decentralized "rules of the game." Such a legal framework has several basic functions:

(1) to define the universe of property rights in the system,

(2) to establish a framework for exchanging those rights,

(3) to set the rules for the entry and exit of actors into and out of productive activities, and

(4) to insure that the overall market structure and the rules of market exchange promote competition.

Each of these functions typically involves numerous areas of law. Property rights are defined in practice in most market economies by a wide array of laws regulating the ownership and use of real, personal, and intangible property, as well as shares in going concerns. Contract law governs the exchange of those rights. Company, foreign investment, and bankruptcy laws are among the subset of laws that govern the entry and exit of actors into and out of productive activities. General rules of market structure and competition tend to be laid out in antimonopoly and unfair competition laws, while more specific rules in particular sectors may be governed by more detailed laws and regulations.

This paper describes the evolving legal framework in the CSFR using this general classification.[1] Essentially the same legal framework exists in the Czech and Slovak republics, although the legal frameworks of the two could diverge considerably in the coming

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[1] This paper is part of a larger research project sponsored by CECSE and LEGEC to study evolving legal frameworks in Eastern Europe. Similar country studies have been completed on Poland, Romania, Bulgaria, Slovenia, and Hungary. The paper only briefly touches upon privatization and does not discuss certain other areas of law that are also important to the private sector, including banking, taxation, and labor law. Although a critical area of reform, privatization is a transitional issue, whereas the paper seeks to address the longer-term legal structure. The other areas of law are omitted due both to space limitations and to likely coverage in other World Bank or external studies.

months and years if the country separates as anticipated. The CSFR is somewhat different from its Central and Eastern European (CEE) neighbors, particularly Poland and Hungary, in that its pre-war legal system was more thoroughly abrogated during the socialist period. There are thus fewer people (in or out of government) who are familiar with market-oriented legal principles and practices. On the other hand, in 1989 the CSFR had the advantage of starting with a relatively "clean slate" on which to craft modern laws. In some areas of law, such as company, contract, and antimonopoly law, legal reform in the CSFR is relatively well-advanced and could serve to some degree as a model for other reforming socialist economies. In others, including constitutional and real property law, legal reform is embroiled in political controversy and is lagging behind developments in some neighboring countries. Institutional capacity in the CSFR's judicial system appears to be relatively weak--ill-prepared to cope with the skyrocketing demands now emerging in the newly reformed system.

Rights to Real Property

Rights to real property are in a tremendous state of flux in the CSFR. As the basic legal framework of real property rights is being redefined, the clash of competing claims of current tenants, former owners, and new would-be purchasers is creating widespread uncertainty. Meanwhile, the land registry and regulatory institutions left over from the socialist period are in need of major overhaul. A real estate market is just beginning to emerge and is still in disequilibrium.[2]

Defining Basic Property Rights

Constitutional foundations. The constitution of a country, although generally not a detailed legal document, sets the basic rules under which an economy and its government will operate. Rules regarding property ownership are among the most important of such rules. Socialist constitutions typically gave precedence to state or socialized ownership and severely restrict the domain for private activity. Constitutional reforms throughout the CEE region in the last two years have, among other things, attempted to "level the playing field" by granting unhindered rights to private ownership of property and private entrepreneurial activity.

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[2] Extreme price variation is one indicator of this disequilibrium. For example, the rental price of refurbished commercial space in a top location in Prague can reportedly vary from under $100 to $450 per square foot.

CSFR's first constitution was adopted in 1920.[3] A new constitution, based firmly on socialist principles, was adopted in 1948.[4] A second socialist constitution was adopted in 1960[5] and amended in 1968.[6] The CSFR did not adopt a new constitution after the 1989 revolution, although the Federal Assembly elected in June 1990 was supposed to draft a new constitution within its two-year term. The process was stalled by political disagreements over governmental structure and the distribution of powers among the republics and between levels of government, and it could not proceed further until basic questions on union or disunion were resolved. However, numerous amendments were made to the 1960 Constitution to bring its provisions in line with the needs of a private market economy. The Constitutional Law on Fundamental Rights, adopted in January 1991,[7] grants all persons the right to own and inherit property, and provides equal protection for all types of ownership rights.[8] It provides for expropriation only "in the public interest" and only according to law and with compensation.[9] It further provides that "everyone has the right to freely choose their profession...[and] to undertake other economic activities.[10] Thus, although governmental structure is still an open question to be resolved only when new federal or republic constitutions are enacted, the constitutional barriers to private ownership and private entrepreneurship have been removed through amendments to the old socialist constitution.

Civil Code elaborations. The primary legislation defining property rights in detail in the CSFR is the Civil Code.[11] The existing Civil Code dates from 1964. As in the Civil

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[3] Constitution of the Czechoslovak Republic of February 29, 1920, in Sbirka Zakonu a Narizeni, 1918-1974.

[4] Constitution of May 9, 1948, in Peaslee, Constitutions of Nations, 1950, Volume I, p. 602.

[5] The Constitution of the Czechoslovak Socialist Republic of July 11, 1960, published in Prague by Orbis, 1967.

[6] Zakony o federativnim usporadani CSSR, published in Prague by Orbis, 1972.

[7] Published in Czech in Lidove Noviny, January 16, 1991. Translated in JPRS-EER-91-025-S, February 28, 1991.

[8] Article 11(1).

[9] Ibid., Article 11(4). A similar provision existed in the previous constitution but was virtually irrelevent due to the prohibition on private ownership of property.

[10] Article 26(1).

[11] When Czechoslovakia became an independent state after World War I, the Czech Republic continued to apply the Austrian Civil Code ("Buergurliches Gesetzbuch") of 1811, which had previously been in force in the Czech Kingdom. Slovakia, in contrast, continued to rely on Hungarian law, which at the time had a Commercial Code (dating from 1876) but no unified civil code. In 1950 the existing law in both republics was replaced with a new Civil Code, which included certain socialist principles and included directives of state organs (including the plan) as part of the law. A new Civil Code and an Economic Code were adopted in 1964.

Codes of other CEE countries during the socialist period, this Code originally established a hierarchy of property rights among state, cooperative, personal, and private property. State property, the "highest" form, encompassed major means of production and was accorded special legal status. Personal property included the family house (up to a size of 120 square meters) and small items for personal use. Private property, the lowest of the hierarchy, referred to private ownership of means of production (in practice mostly real estate).

Although the 1964 Code continues in force, major amendments were made at the beginning of 1992 that abolished the socialist hierarchy of property and equalized the legal status of state and private property. A thorough overhaul of the Civil Code is being planned but will take several years.

Eliminating the Monopoly of State Ownership

Unlike in Poland and Yugoslavia (where a significant amount of real property remained in private hands), the state owned or controlled almost all real property in Czechoslovakia during the socialist period. Industrial enterprises and the real property they occupied was all under state ownership, as were most apartment buildings. Although agricultural land was never officially expropriated during the socialist period, rights of use and transfer were allocated to state farms and cooperatives. The only real property that remained in private hands was single-family housing, a few apartment buildings, and the land on which these were built (including small adjacent yards).

Changing the basic definition of property rights to expand the scope for private property is the first, and in some sense the easiest, step in reforming real property rights. Actually implementing these changes in rights, primarily by eliminating this virtual monopoly of state ownership, is much more problematic because of the tremendous distributional implications. The process entails privatizing commercial property through restitution to previous owners or transfers to new purchasers, and developing an active rental market in property still held by the state.

Restitution. CSFR moved quickly after its 1989 revolution to reverse the nationalizations of the socialist era by returning both real property and businesses to former owners. Four laws govern the restitution process. The first, the "small" restitution,[12] applies to property (mostly apartment houses and small businesses) nationalized between 1955 and 1961 by two sets of government decrees that contravened existing law even at that time. The deadline for claims under this first law was April 1, 1991, and an estimated 70,000 properties were involved. Because the original takings were illegal, restitution under

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George E. Glow, "The Legal System of Czechoslovakia," Modern Legal Systems Cyclopedia, pp. 85-115.

[12] Law on the Alleviation of Some Property Injuries, Law No. 403/90.

this law is primarily in-kind. The second, the "large" restitution law,[13] covers property (mostly companies, including any real property owned by them) nationalized from individuals[14] under prevailing law after the Communists came to power on February 25, 1948. It involves 5-10 percent of all state property, significantly more than the first law. However, it does not cover most of the major nationalizations of large industrial enterprises, which were undertaken by the interim government between 1945 and 1948. The deadline for claims under the second law was October 1, 1991. Restitution under this law is primarily financial (mostly in vouchers that can be invested in newly-privatized companies or shares in the companies themselves) rather than in-kind, reflecting the promise of compensation in the 1948 nationalization law that was in fact never paid. Emigres were eligible to claim restitution under the first law, but claims under the second were limited to resident citizens. Although many claims under these two laws have been settled, many disputes (often between restituted owners and existing tenants) are now entering the courts.

The third restitution law concerns agricultural and forestry land.[15] The land law gives use and transfer rights to such land back to the legal owners, provided they are resident citizens. It could apply to as many as 3.5 million title-holders, despite the fact that less than 500,000 are still engaged in agriculture. There is widespread concern that this restitution not disrupt agricultural production. The deadline for claims is December 31, 1992.

Finally, a fourth law, adopted by the Parliament in April 1992, returns land confiscated from ethnic Germans and Hungarians after World War II, as long as the former owners remained in the country and regained their citizenship.

This patchy and complex legal framework has left many problems in its wake. First, the heavy reliance on restitution-in-kind (particularly in the first law) has led to many disputes--often between competing claimants or between former owners and current tenants--that are now beginning to clog the court system. Second, the legal precedence given restitution over privatization has created great uncertainty among potential investors and has complicated privatization, particularly in the case of small businesses and housing. Finally, restitution is poorly coordinated with other laws that restrict the ownership rights of new owners. The most important of these involve housing. New private owners of apartment buildings are still subject to extremely tight rent control and limitations on eviction, yet they must assume the costs of maintenance and repairs.

<u>Privatization</u>. Business or residential real property that is not returned in-kind to former owners is potentially available for sale to new owners. In the case of land and buildings used by state-owned enterprises, privatization of real property is one part of the

[13] Law on Extrajudicial Rehabilitation, Law No. 87/91, February 1991.

[14] Property taken from political parties and churches was thus excluded from restitution.

[15] Law on Land and Agricultural Cooperatives, Law No. 229/91, June 1991.

larger task of privatizing the firms themselves. Privatization of state-owned firms is proceeding rapidly in the CSFR, perhaps more rapidly than in any other CEE country. Two laws cover the privatization process. The first is the "small privatization" law,[16] pursuant to which some 100,000 small enterprises (such as retail shops and restaurants) have been sold by local authorities through public auction. Most sales under this law have involved only machinery, furniture, or inventories. Rights to real property have been included in only a small minority of these cases because of the existence or fear of competing restitution claims. However, a purchaser does acquire the right to rent the premises for 3-5 years at fixed rent, after which the rental contract is subject to renegotiation.

Privatization of larger firms, and the real property on which they sit, is also affected by restitution claims, but to a somewhat lesser extent than in the case of small firms. Over 2000 large companies are being privatized through the "first wave" of the "large privatization"[17] effort in the two republics, and a second wave of similar magnitude will be privatized in late 1992 and 1993. Privatization of the large firms is being accomplished through direct sale to individual purchasers, auction to the public in exchange for vouchers,[18] restitution to former owners,[19] or in many cases some combination of these 3 routes.[20] Unlike in the case of small privatizations, the real estate owned by the firm is generally transferred along with other assets.

Privatization of state-owned housing has been stalled in the CSFR. The last Parliament failed in May, 1992 to pass a draft law pursuant to which houses not already returned to former owners[21] and apartments would be sold by local governments[22] to

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[16] Law on the Transfer of State Property of Certain Businesses to other Physical or Legal Persons, Law No. 427/90, October 1990.

[17] Law on Conditions of Transfer of State Property to Other Persons, Law No. 92/91, February 1991.

[18] Before the end-February 1992 deadline, every CSFR citizen aged 18 or older was eligible to buy a book of coupons worth 1000 investment points for Kcs 1000. Some 8.5 million citizens--about three-fourths of all adult citizens-- purchased coupons. These coupons can be used to purchase shares in individual companies or can be invested in one of several competing investment funds.

[19] In most cases the property has been significantly altered since nationalization, so that financial compensation will be provided to former owners rather than restitution-in-kind. Three percent of all privatization receipts are earmarked for a compensation fund for that purpose.

[20] The ratio of assets being sold through direct sale to assets being sold via voucher auction is approximately 50:50. The Privatization Ministry in each Republic selects the method among competing proposals put forward by the enterprise itself or outside parties. Several criteria are used to evaluate proposals, including not only price to be paid but also future plans for restructuring, labor use, and additional investment. Each proposal must include a plan for dealing with any restitution claims filed under the large restitution law.

[21] An estimated one-fifth of state-owned housing has been returned to former owners under the first and second restitution laws, leaving four-fifths to be covered by a program of housing privatization. Tenants who happen to live in formerly-nationalized apartments are unfortunate in that they will be unable to purchase their

tenants. The main stumbling point was price--how it would be determined, how much subsidy it would reflect, who would provide credit, and at what rate of interest. The newly-elected legislators are expected to take up the issue again later in the year.

Revising the Regulatory Framework

Rent and tenancy restrictions. The CSFR faces an array of regulations on real property that have been carried over from the socialist period but need rethinking as the economy is transformed to a market-based one. Rent and tenancy regulations are among the most distortionary. Rent control has long kept housing rents extremely low, far out of line with rents that would prevail in a free market and even too low to support basic upkeep and maintenance. Although permissible rents were recently doubled,[23] they are still extremely low. Combined with this rent control are tight restrictions on eviction. A tenant cannot be evicted unless alternative equivalent housing is found. Given the acute shortage of commercial space in Prague (caused in part by these rent and tenancy regulations that prevent housing from being converted to commercial space), speculation in Prague is leading some private enterprises to buy up available space at very high prices, sometimes paying tenants large sums to leave voluntarily or actually building alternative housing in other areas of the city to meet the legal requirements for eviction. The shortage of space and resulting high prices make it difficult for small entrepreneurs to find affordable space in which to open new businesses.

Land registration. Another critical challenge is updating and modernizing the land registry. Although some transfers and encumbrances continued to be registered in the land registry during the socialist period, not all were registered, and thus the land records for that period are not fully reliable. In particular, many transfers to and among state entities were not recorded.

The land register in the Czech Republic was originally designed on the Austrian model, while that in Slovakia followed the Hungarian one. All transfers made until 1951 were duly entered in the old register, because such entry was the decisive step in gaining firm title under the old Civil Code. From 1951 (when a new Civil Code was adopted) until 1964, the old cadastre continued to exist, but entry in the register was no longer decisive in proving title. Rather, a contract of real estate transfer was decisive if registered with the state notary. The period from 1951 to 1964 is the most unreliable with regard to the accuracy of land transfer and ownership records. In 1964, when the most recent Civil Code was adopted, the old cadastre books were closed and a new land register was opened.

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apartments at subsidized prices like other tenants.

[22] The 1990 Law on Municipalities made local governments the clear owners of publicly-owned apartment buildings.

[23] Rent of a 2-room flat thus rose from 100 to 200 Kcs (about $7) per month.

Registration of real estate contracts with the state notary continued to be the decisive step in obtaining firm title. However, because the state notary had a duty to send all contracts for entry in the new register, this register is thought to be quite an accurate record of real estate transfers and encumbrances after 1964.

Mortgage Lending. Real estate mortgages were rarely used after 1949. As in other CEE countries, there was little need for mortgage financing during the socialist period. Housing costs were low, and foreclosure was not a viable option due to the near impossibility of eviction. Because both banks and employers were state-owned, banks could readily garnish wages if needed to satisfy any overdue payments. The concept of a mortgage (or pledge) was omitted altogether from the Civil Code in 1964.[24]

These conditions are changing rapidly, and mortgage lending will need to develop as an independent and viable instrument of finance as the real estate market grows through restitution, privatization, and increased rental of state-owned space. This will require the growth of market-oriented financial institutions, a reintroduction of concepts of collateral security into law and everyday practice, the eventual phase-out of heavily subsidized interest rates, and an easing of foreclosure (and thus presumably eviction) procedures to transform real estate collateral into a true instrument of security. The concept of collateral was reintroduced by a 1988 amendment of the Civil Code in the form of a pledge on immovable property. The land record is supposed to serve as a central registry to inform third parties and determine priority. It will take time and practice, however, to transform this concept into a practical and widely-used form of security.

Rights to Intellectual Property

Laws on intellectual property had little meaning in the domestic economies of the CEE countries during the socialist period. State control over the economy was pervasive, and inventors and creators tended to work within the state apparatus. Inventors were given credit for their inventions in the form of lump-sum cash awards, calculated generally as a percentage of the savings achieved by the design or a percentage of the net return on the investment. The socialist organization upon whose behalf or within whose contractual relation the invention was created obtained an "authorship certificate," which gave it the right to use the invention and apply for patent protection abroad. Because the rights to the invention remained essentially with the state apparatus, there was little experience with the enforcement of private patents, which will be the challenge of the CSFR's new intellectual property regime.

The CSFR moved in the late 1980s and early 1990s to update its intellectual property legislation to adapt it to the needs of a market economy. A new trademark law was passed

[24] I am grateful to Jaroslav Sodomka for helpful information regarding the history of mortgage finance.

in 1988,[25] and the existing patent[26] and copyright[27] laws underwent major amendments in 1990. The 1990 amendments came on the heels of the U.S.-Czechoslovakia Trade Agreement,[28] which included specific conditionality in this area in return for "most-favored nation" status.[29] These changes have brought Czechoslovak legislation generally in line with international norms. In the patent area, for example, the amendments establish a 20-year term for patents (extended from 15 years under the previous version), extend protection to products and processes in all areas of technology, limit the use of compulsory licenses, and make decisions of the patent office subject to judicial review. In the area of copyright, the amendments extend protection to computer programs and data bases, audiovisual works, and sound recordings.

On the international front, the CSFR has long cooperated in international conventions, although the protection they provide in the country has generally been a matter of domestic law. In the patent and trademark area, CSFR is signatory (among others) to the Paris Convention for the Protection of Industrial Property (1883), the major international treaty in that area,[30] and the most current text of the Madrid Agreement Concerning the International Registration of Marks (Stockholm, 1967).[31] In the copyright area, the CSFR is a signatory

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[25] Trademark Law, Law No. 174 of November 8, 1988, in force since January 1, 1989. This law provides for registration with the Office of Inventions and Discoveries and grants an initial 10-year term of protection that can be extended indefinitely by 10-year periods.

[26] Law on Discoveries, Inventions, Rationalization Proposals and Industrial Designs, Act No. 84/1972, as amended.

[27] Law No. 35/1965.

[28] Agreement on Trade Relations Between the Government of the United State of America and the Government of the Czechoslovak Federal Republic, April 12, 1990.

[29] The Agreement confirms the commitments made in the Universal Copyright and Berne Conventions and specifically requires 50 year protection for computer programs and databases, audiovisual works, and sound recordings.

[30] The two most important rights granted by the Paris Convention are national treatment of foreigners and right of priority in registration. The right to national treatment obligates countries to treat foreigners as they would their own nationals under their own laws. The right of priority gives the holder of a patent one year to file in other member countries without losing priority rights over other potential claimants to the invention. However, the criteria for patentability is still a question of domestic law. Thus, the Paris Convention would do little to protect patents without a Czechoslovak law that provided reliable substantive patent rights.

The Paris Convention also grants national treatment and right of priority to trademark owners. Right of priority lasts six months for trademarks, as opposed to one year for patents. The Paris Convention does, however, provide a bit more substantive protection for trademarks than for patents by automatically protecting well-known marks, apparently without requiring that the mark be registered in other member countries.

[31] The Madrid Agreement protects both trademarks and service marks by allowing members of signatory countries to register their trademarks with the International Bureau of the World Intellectual Property Organization (WIPO) in Geneva. The mark must first be registered in the country of origin, whose

to the Universal Copyright Convention and the Berne Convention (Paris texts of 1971), which protect literary, scientific, and artistic works.[32]

Some lawyers note uncertainties in the transition from the old to the new system, particularly with regard to rights previously conferred through authors' certificates. Do those certificates continue to confer rights? If so, who owns those rights, particularly in the case of newly privatized entities? Does usage by others prior to the 1990 amendments confer any rights? What happens if an invention was made and recognized, but never actually used? These are the types of transition questions that are yet to be resolved in the move to a new intellectual property regime.

Enforcement capacity is an issue in all areas of intellectual property law. Although a registration procedure exists, it is often slow,[33] and how a holder of intellectual property rights can in practice protect these rights if another person infringes them is still uncertain and untested. In the socialist state this was not much of an issue, because almost all rights were held by the state. However, enforcement will emerge as a critical issue as the domestic private sector and foreign investment grow. Giving true meaning to these rights will require institutional strengthening in the registration agencies and the courts to insure that infringements can be identified, halted, and punished as appropriate.

Company Law

The CSFR adopted a new company law--the Commercial Code--on January 1, 1992, that is the most comprehensive and arguably the best such law to emerge in Central and Eastern Europe. This Code covers both company law and commercial contracts, replacing the Economic[34] and International Trade Codes[35] passed in 1963,[36] the Law on Joint Stock

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administration applies for registration with WIPO. The effect of WIPO is that the trademark is protected in all signatory countries. Upon notification of the registration of a trademark, national administrations may still be authorized by national law to declare that certain trademark protection cannot be granted in that territory. Thus, like the Paris Convention, the Madrid Agreement depends ultimately on domestic law in protecting substantive rights.

[32] Under Berne, no formalities are required to protect a work in other member countries. Whereas in the country of origin protection may depend on registration, no central registration exists for international protection; upon creation, works are protected.

[33] For example, it reportedly can take one year to register a trademark and 18 months to have it published.

[34] Economic Law code no. 109/1964, as amended.

[35] Law No. 101/1963 on legal relations in international trade.

Companies of 1990,[37] and former laws on cooperatives.[38] It applies equally to domestic and foreign entrepreneurs and thus also replaces former legislation specifically tailored to foreign investment.[39] It also has a section on unfair competition.

The company section of the Code[40] generally follows the German model and sets out four types of companies--the joint stock company, the limited liability company, the "comandite" company, and the unlimited liability company. A separate chapter then covers cooperatives.

Characteristics of a Joint Stock Company

The most formal type of company provided for in the Commercial Code is the joint stock company, or "akciova spolecnost" (abbreviated as "akc. spol." or "a.s."). It resembles the German AG ("Aktiengesellschaft"), the French S.A. ("societe anonyme"), and the American public corporation. This form is intended to be used by large firms, in which ownership is widespread and thus necessarily separated from management. Tighter regulations and more extensive reporting requirements apply to this form, primarily to protect the public in public offerings and to give shareholders tools to oversee management. About 3000 joint stock companies had been registered by the end of 1991, most being either state-owned enterprises or foreign joint ventures.

Capital and share requirements. Minimum capital of 1,000,000 Kcs. (approximately $37,000) is required to set up a joint stock company. This level of minimum capital is in the middle range for European countries but very high by U.S. standards.[41] It represents a ten-

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[36] The pre-war Commercial Code was abolished in 1950 with the adoption of a new Civil Code. Both were then replaced in 1963 by 3 new Codes--Civil, Economic, and International Trade--which were supposed to represent the full achievement of socialism. Of these, only the International Trade Code followed generally accepted western ideas of contract, as found, for example, in the Hague Convention of 1964, the New York Convention on Prescription of 1973, and the Vienna Convention on sales contracts of 1980.

[37] Law no. 104/1990 on Joint Stock Companies. This law replaced the extremely outdated 1949 Joint Stock Companies Act (Law No. 243/1949) and introduced modern company forms (generally along German models) into the country's legal framework.

[38] Law no. 162/1990 on agricultural cooperatives; Law no. 176/1990 on housing, consumer, manufacturing and other cooperatives.

[39] Law no. 173/1988 on companies with foreign ownership participation, as amended in Law 112/1990.

[40] Part II.

[41] While substantial minimum capital requirements reassure potential creditors, they act as barriers to entry to new entrepreneurs. An alternative and much needed means to protect creditors would be to increase the availability and credibility of collateral through changes in laws, institutions, and attitudes. In such a way a legal framework with more extensive property rights (i.e. contingent or "collateral" rights on moveable

fold increase from the 100,000 Kcs. under the previous joint stock company law. Existing firms have one year to increase their capital to the 1 million Kcs. minimum or change their form; this is likely to be a major burden for many firms.

Capital contributions can be either in money or in kind. The value of in-kind contributions must be supported by an expert assessment.[42] At least 30 percent of monetary contributions must be paid in before the first general meeting of shareholders, with the remainder due within one year (or shorter period if so provided in the company's statutes).[43] In addition to minimum capital, each company must maintain a reserve fund in readily realizable assets, initially 10 percent of capital, to be supplemented each year by at least 5 percent of net profits up to 20 percent of capital.[44]

The law provides great flexibility in structuring ownership interests in a firm, although it is likely to be some time before widespread use of elaborate share structures emerges in the CSFR setting. Registered or bearer shares are allowed,[45] and the company may, with some limitation,[46] also issue employee shares with certain advantages. Up to one-half a firm's equity may be in the form of preferred shares (i.e. with a dividend preference and with or without voting rights).[47] Interest-bearing shares were permitted in the 1990 joint stock company law but are not permitted in the Commercial Code.[48] The law also permits companies to issue debentures that are convertible into shares within a certain time period.[49]

Shares entitle the holder to dividends and a percentage of assets upon liquidation. Although a one share-one vote rule generally applies, the company statutes may set a

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property) could replace distortionary direct controls (i.e. high minimum capital requirements).

[42] Para. 165 (2).

[43] Para. 177.

[44] This reserve requirement appears to be quite high and should be reviewed to weigh its supposed benefits against the burden it imposes on the newly emerging private sector.

[45] Para. 156.

[46] The company may not give more than 5 percent of equity free of charge to employees, and employee shares may be transferred only among current or retired employees (Para. 158).

[47] Para. 159.

[48] Para. 159 (2).

[49] Para. 160.

maximum number of votes per shareholder. Unlike in some other countries, however, it is not possible to assign more than one vote per share.[50]

Corporate governance. In line with the German model, the Code provides that each joint stock company must have both a Board of Directors[51] and a Supervisory Board. The Board of Directors must have at least 3 members and they are elected by the general meeting of shareholders (or by the supervisory board if so stipulated in the company statutes).[52] The Supervisory Board, which oversees the Board of Directors, must also have at least 3 members. In companies with more than 50 employees, one-third of the supervisory board's members (or up to one-half, if the company statutes so provide) are elected by the employees (again following the German model of "codetermination"), with the remainder elected by the general meeting of shareholders.[53]

Quorum and voting rules determine the power of individual shareholders to influence outcomes at the general meeting. Pursuant to the law, the presence of shareholders owning at least 30 percent of company equity constitutes a quorum,[54] and most decisions require majority vote,[55] although either the quorum or the voting rule can be changed by company statute. The flexibility to change these rules, plus the ability to limit the maximum number of votes per shareholder, gives the company wide latitude to separate the power of corporate governance from shareholding status. This might be useful, for example, in negotiations between a foreign investor and local investors or the government, if the domestic partner wants to maintain majority ownership but the foreigner requires veto power over major corporate decisions. In such case, high quorum and/or supramajority voting rules can be used to give the minority shareholder effective veto power, or the voting power of the majority shareholder can be limited to equalize voting power per shareholder.

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[50] In Poland, for example, certain shares can be given up to five votes. See Gray, et.al., "The Legal Framework for Private Sector Development in a Transitional Economy: The Case of Poland," Georgia Journal of International Law 22:2, Summer 1992.

[51] The Board of Directors in this model has somewhat more hands-on responsibility than the outside Board typical of U.S. corporations. It usually meets twice a month. The day-to-day running of the company is the responsibility of the General Manager appointed by the Board. In practice the Supervisory Board is not as important as is typical in Germany.

[52] Para. 194.

[53] Para. 200.

[54] Para. 185 (1). This is a rather low quorum requirement by international standards. Fifty percent is a more common rule.

[55] Para 186 (1). Certain decisions, such as a change in company statutes, a change in rights attached to particular types of shares, an increase or reduction in equity, and dissolution of the company, require two-thirds majorities in all cases. Para. 186 (2), 187 (2).

The activities of directors should in principle be limited not only by shareholder oversight, but also by laws on fiduciary responsibility, conflicts of interest, insider trading, and fraud. Yet legal principles such as these are underdeveloped in CSFR, as in other CEE countries. Furthermore, the legal provisions that do exist are difficult to enforce in practice given the shortage of well-trained lawyers and judges and the difficulties of obtaining evidence (due in part to underdeveloped "discovery" rules). The weakness of the legal sanctions for misconduct makes corporate governance even more difficult in this setting than in mature market economies.

Characteristics of the Limited Liability Company

The limited liability form of company, or "spolecnost s rucemin omezenym" ("spol. s r.o." or "s.r.o."), is less formal than the joint stock form. It resembles the German GmbH ("Gesellschaft mit beschrankter Haftung") the French S.A.R.L. ("societe a responsibility limitee"), and to some extent the American "closely-held" corporation. Because it offers the benefits of limited liability to all investors yet minimizes regulatory and reporting requirements, it is preferred by most small and medium-sized entrepreneurs. The maximum number of participants is 50.[56] Minimum capital is 100,000 Kcs. (approximately $3900),[57] with at least 20,000 Kcs. from each participant[58] (at least 30 percent of which is paid in upon registration[59]). Because it is intended to be a vehicle for investment by a small group of investors who are acquainted with one another, one participant cannot transfer his share except with the approval of the others.[60]

Rules on corporate governance and reporting requirements are much simpler than in the case of the joint stock company. Rather than a Board of Directors, the limited liability company is managed by one or more "statutory representatives" appointed by the general meeting from among the participants or other persons.[61] As with the joint stock company, rules on required quorum (generally one-half of all voting rights represented) and voting majority at the general meeting (generally simple majority) are set in the law but can be

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[56] Para. 105 (3).

[57] Para. 108 (1). Although lower than the minimum capital required for a joint stock company, this is still a relatively high level.

[58] Para. 109 (1).

[59] Para. 111.

[60] Para. 115.

[61] Para. 133.

altered by company statute. A supervisory board is not required but can be set up if the company agreement so stipulates.[62]

Characteristics of the Two Partnership Forms

The two partnership forms, the "unlimited liability company" and the "comandite" company, are analogous to general and limited partnerships in the U.S. In the former--"verejna obchodni spolecnost" ("ver.obch.spol." or "v.o.s." or surname plus "a spol." [& co.]), all partners have unlimited joint and several liability with regard to the partnership's obligations, and they share equally in company profits unless the company agreement stipulates otherwise. Participants choose a commercial director from among themselves, and all have full access to the books and records of the company. In the "comandite" company--"komanditini spolecnost" ("kom. spol." or "k.s."), one or more participants (the general partners) have unlimited liability and responsibility for management, while the liability of the others (the "sleeping" partners) is limited to their capital contribution. In other respects it is similar to the unlimited liability company. Both forms of partnership have an important advantage over the joint stock and limited liability company forms: they are not subject to tax at the entity level under the new tax law in force as of January 1, 1993.[63]

Setting up a Company

Although the new Commercial Code establishes a modern and well-designed legal framework for the establishment of companies, the process of actually setting up a company in the CSFR can be very complicated indeed. The firm must prepare the company's founding contract and statutes[64] in the form of a notarial deed,[65] and apply for registration with the commercial registry.[66] The main bureaucratic complaint at the present time is not with notaries or the Commercial Registry, although the latter in particular can be a bit

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[62] Para. 137.

[63] Although it has long been the rule in the U.S., this pass-through tax treatment, whereby partners are taxed but not the partnership itself, is an innovation in the CEE countries. During the socialist period, all partnerships were taxed as legal entities. Poland, which recently introduced a limited partnership form of company with pass-through tax treatment, is the only other CEE country to adopt this approach so far.

[64] The latter is mandatory only in the case of the joint stock company.

[65] Notaries in CSFR are still public employees, but the profession will soon be privatized. Although the process of preparing the founding documents can take several weeks, lawyers report that most notaries do not interfere unnecessarily in the substance of the documents as they have been sometimes reported to do, for example, in Poland. See Gray, et. al., supra note 50. The Polish situation may change, however, due to the recent privatization of the profession.

[66] There is a 3000 Kcs. (about $110) filing fee for registration.

cumbersome.[67] Rather, businessmen and lawyers are now concerned with another law that came into force January 1, 1992--the "Law on the Pursuit of Trade Activities".[68] This law requires most companies[69] to obtain a business license before they can register with the Commercial Registry. Although in theory designed to insure professional competency in technical areas of work, the law appears far more encompassing and restrictive than such a purpose would justify. For example, in many cases the law requires 3 years of apprenticeship before a license can be obtained. The annexes specify certain activities covered by the law, but even unspecified activities require general licenses. A separate application is reportedly needed for each business activity, and a fee of 1000 Kcs. is charged for each application. The applicability of the law and procedures for obtaining licenses are still being worked out, but local lawyers report that the law is already causing confusion and delay.

Furthermore, companies must fulfill other bureaucratic requirements before a business license will be issued. For example, a permit from the local council is needed to open a business office. To get this permit the business must show that it has a lease and that the property has been zoned as "commercial" space. If the space is zoned as residential, the owner will have to apply for a "change of use" permit under the Construction Act before the lease will be approved by the local council. If the company is foreign, it must also have a notarized deed of incorporation from its home government with a certified translation into Czech, and it must show a notarized power of attorney for local proxy. If it wants to appoint a foreign manager, it must obtain a residence permit[70] from the Ministry of Interior, which in turn requires a police statement showing a clear criminal record, a medicat certificate showing an absence of infectious diseases, and a signed and notarized lease agreement (and, in the case of a sub-lease, a certificate from the owner that the tenant has the right to sublease).

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[67] It generally takes a few days for the Commercial Register to review and register company documents, provided they are in proper form. This is very different from the situation in Hungary, for example, where it can take six months to register a company. See Gray, et. al., Hungarian Legal Reform for the Private Sector, WPS 983, September 1992.

[68] Dated October 2, 1991; translation in JPRS-EER-92-012-S, January 30, 1992.

[69] The law does not apply to certain enumerated professions, such as doctors, lawyers, or accountants, or to firms engaged in certain specialized areas such as banking, mining, energy, agriculture, railroads, telecommunications, pharmaceuticals, or broadcasting. Separate licenses are required, however, for many of these activities.

[70] There is also legal uncertainty with regard to the definitions of "resident" under various laws--the foreign exchange act, the tax law, and the residence permit regulations--and how they interact. Under the former two, being a resident has serious potential consequences for a foreign manager; under the foreign exchange act, a resident is supposed to bring all foreign assets to the CSFR, while the tax law imposes worldwide income taxation on residents. Yet, pursuant to the third, the foreigner must get a residence permit to work in CSFR. As these laws are new, lawyers are now grappling with how to deal with them.

In sum, there are still many bureaucratic hurdles to the opening of a business. They must be satisfied in succession and together are extremely cumbersome and time-consuming. Czech authorities would be well-advised to review the applicability of this law and related requirements and limit them to the extent possible, in order to reduce the barriers to entry for new private entrepreneurs.

Foreign Investment

As noted above, the new Commercial Code applies to both foreign and domestic investors, thus supplanting the previous foreign investment law.[71] The CSFR is the only CEE country so far to have thus eliminated specialized foreign investment legislation from its legal framework altogether.[72] Thus, foreigners can generally freely invest in the country without limitation on size of holdings, sphere of activity,[73] or repatriation of profits, and without prior approval from any government agency. Foreign investors do continue to receive special tax incentives not available to domestic entrepreneurs, including lower income tax rates (applicable only until the end of 1992)[74] and discretionary tax holidays.[75]

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[71] Law no. 173/1988 on companies with foreign ownership participation, in the version of law 112/1990. The 1990 amendments to this law had already significantly liberalized the environment for foreign investment, allowing up to 100 percent foreign ownership, providing guarantees against expropriation, and permitting repatriation of profits in hard currencies (but only subject to availability from the company's export earnings and after mandatory sale of 30 percent of foreign exchange earnings to the State Bank). All foreign investments under that law required the approval of the Minister of Finance. The law was also an interim step in that disputes with other domestic firms were to be handled by a special judicial body called the State Arbitration rather than by the regular court system.

[72] The new Code does have a short section--Chapter II--dealing specifically with "business activities of foreign persons." It applies only to businesses not incorporated under CSFR law; foreign-owned Czechoslovak firms do not fit within this classification. This section is very liberal, giving foreigners equal rights with domestic entrepreneurs to carry out business, allowing expropriation of property only "by law and in public interest which cannot be satisfied otherwise," and guaranteeing full and immediate compensation in such cases of expropriation. Para. 25.

[73] A few sectors of strategic importance may be closed to foreign participation under separate legislation.

[74] For 1992, the domestic tax rate is 55 percent. Joint ventures with over 30 percent foreign ownership are subject to a 40 percent rate if net income exceeds 200,000 Kcs., or 20 percent if net income is lower than that amount. Beginning January 1, 1993, both domestic and foreign entities will be subject to the same rate of 45 percent.

[75] Tax holidays of at least one year and (more often two to four years) are available to companies registered before the end of 1992 with a tax liability of less than 1 million Kcs. in the particular calendar year. If the tax liability is greater, the grant of the holiday is discretionary. The amounts saved by the tax holiday are supposed to be reinvested within 2 years in the business. "Legal and Taxation Consequences of Investing in Czechoslovakia", in Czechoslovak Financial Review 2:8, April 15-30, 1992.

Most foreign investment is entering CSFR as part of the privatization process, as foreign companies bid to purchase all or part of firms being privatized. The Czech Republic attracted foreign investment commitments of more than $5 billion from about 180 foreign firms through its first "wave" of privatization (covering more than 900 large companies and 100,000 small ones). Of this, American companies had committed some $1.4 billion as of mid-1992, and German companies some $2.5 billion.[76] Although the basic legal framework for such investment is clear, one unclear area of major concern to these companies is the question of responsibility for environmental liabilities incurred in the past. The Czech authorities are trying to resolve this question by promising indemnification for existing environmental liabilities (within limits) that are unknowable at the time the venture is negotiated, but whether this will suffice in practice is still unclear.

As in most other CEE countries, foreigners cannot own real property in CSFR. This prohibition is contained in the foreign exchange law, which states that a foreign exchange expatriate may acquire ownership rights in real property in the Czech and Slovak Federal Republic "by inheritance, marriage, swap, or only when stipulated by a special act."[77] A 100-percent foreign-owned Czechoslovak company, in contrast, can purchase immovable property.

Contracts

Freedom of contract is one of the most basic principles underlying a market economy. During the socialist period, this principle was relegated to a tiny sphere of private noncommercial transactions, while commercial transactions were governed by the central plan. Legal reforms in CSFR since 1990 have tried to broaden the sphere for private commercial transactions and put them on an equal footing with public ones.

Features of Socialist Contract Law

Czechoslovakia's prewar legal system was abrogated more completely and systematically during the socialist period than that of many of its socialist neighbors. While the pre-war contract regime survived to some extent in most other CEE countries, Czechoslovakia fully replaced its prewar regime with laws reflecting socialist principles. The first change came with the adoption of a new Civil Code in 1950. Although this code contained extensive socialist phraseology and gave directives of state organs the force of law, it still retained many traditional contract principles and types. This Civil Code was then replaced in the early 1960s by three laws--the Civil Code, the Economic Code, and the Code of International Business Transactions--that were supposed to represent the full achievement

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[76] Press release of the CSFR Embassy, May 7, 1992.

[77] Article 25, Law on Foreign Currency Exchange, Law no. 528/1990, dated November 28, 1990, translated in JPRS-EER-91-123-S, as amended by Law no. 228/1992, in force as of July 1, 1992.

of socialism. The Civil Code governed the limited (generally non-commercial) sphere open to private sector transactions, the Economic Code of 1964 governed contracts among legal entities, and the Code of International Business Transactions governed contractual relations between domestic and foreign parties (individuals or firms). Of the three, only the last followed principles of contract common in Western market economies.

Under the socialist system of commercial contracts, contractual freedom was fully subordinated to the needs of the central plan. The plan was adopted annually and had the force of law. Every other related law was drafted in such way that the priority of the plan over individual contracts was assured. There was even a specific category of "pre-contractual" disputes in which the subject matter was not the fulfillment or breach of contract but the very willingness of one of the parties to conclude the contract. Virtually the only way for a party not to conclude such a contract was to prove that the production capacity to fulfill it was not available. More generally, socialist ideology dominated contract law. Contracts that were consistent with the law but considered inconsistent with the rules of "socialist co-existence" could be nullified.

The Current Situation

The old legal basis for contracts has been radically transformed during the past two years. CSFR law on commercial contracts is now contained in two sources, the Civil Code and the new Commercial Code. The Civil Code was extensively amended in 1991 to put private property and private contracts on an equal footing with public ones and to reinstate traditional principles of contract law found in market economies. This law provides underlying general principles of contract, such as offer and acceptance, fraud, duress, mistake, and impossibility, and is considered a broadly acceptable framework within which the practice of private contracting can grow. Although there are plans underway to adopt a new Civil Code altogether, the process is likely to take several years.

The new Commercial Code goes into more detail by providing specific legal rules governing various types of commercial contracts.[78] It addresses not only general contractual concerns, such as what constitutes fulfillment of a contract and remedies for breach, but also provides detailed regulations on many types of contracts--including agreements on the purchase of goods, credit, license of industrial property, storage, contractual work, proxy, commission, inspection, transport, and commercial representation. It also covers agreements in the financial area such as letters of credit, safety deposit, bank accounts, traveler's checks, and security interests. The law thus provides a detailed legal framework that fits into the mainstream of market-oriented commercial practice.

The task of drafting and adopting new codes is small compared to those of (1) building a court system capable of enforcing contracts in a reasonably speedy and consistent

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[78] Part Three of the Code deals with "Commercial commitments."

way and (2) teaching an entire society to think in market terms and accept the notions of risk embedded in the principle of freedom of contract. It will take time to change attitudes and build knowledge, experience, and a body of legal interpretation and thus create adequate certainty for the market to function efficiently.

Bankruptcy

Bankruptcy procedures typical of those in industrial market economies were not needed in the socialist setting, because of the absence of a clear conflict of interest among various claimants--whether shareholders, workers, or creditors. In most Central and Eastern European countries, all of these claimants were arms of the state or ultimately supported by the state. For example, state-owned banks had little incentive to collect on bad debts because state guarantees lied explicitly or implicitly behind such debts. And workers were guaranteed jobs, steady income, and related support systems whether or not their particular firms thrived. Measures in lieu of bankruptcy, including financial "rehabilitation," were relied upon to keep the ailing firm alive and preserve employment.

Bankruptcy takes on much more importance as these economies attempt to transform their economies and develop private markets. Just as a modern and comprehensive enterprise law is needed to govern the entry of new private companies into the market, so a bankruptcy law is needed to govern the exit of private firms who fail. Many new or privatized firms are likely to fail as the economy undergoes fundamental structural adjustment. Bankruptcy law is important not only to firms' shareholders, employees, and creditors, but it is of critical importance to the newly emerging private firms themselves. The ability of banks and other financial creditors to collect on bad debts is a *sine qua non* for the growth of private credit, which is itself essential to the start-up of new firms.

The CSFR recently adopted a new law on Bankruptcy and Settlement.[79] The law has not yet been widely used due to a moratorium on claims against state-owned enterprises in effect until April, 1993.[80] The law is based on prewar German and Austrian law and focuses on liquidation. Reorganization is not an alternative under the law as in the U.S. ("Chapter 11") or in the new Hungarian law,[81] although a pro-rata reduction in outstanding claims of creditors--requiring approval of those creditors--is envisioned as a way to keep the firm operating as a going concern in lieu of liquidation.[82]

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[79] Law 328/92.

[80] The moratorium was originally scheduled to end on October 1, 1992, but was reextended by Parliament for another 6 months soon after the original deadline expired.

[81] See Gray, et.al., supra note 67.

[82] This "compulsory settlement" procedure existed in many CEE countries during the socialist period but was not part of the Czechoslovak socialist legal framework.

While a more active reorganization option may be advisable, by far the biggest challenge in the area of bankruptcy will be equipping the judicial system to deal with the surge in cases that is likely to emerge as real restructuring of the enterprise sector occurs over the coming months and years. If events in Hungary or Slovenia are any indication,[83] the lifting of the moratorium on claims against state-owned enterprises is likely to result in a huge influx of cases. It is highly unlikely that any judicial system--much less one with relatively little exposure to economic matters--could handle such a surge efficiently and effectively. A different--perhaps extrajudicial--mechanism may be needed to handle the stock of bad debt of enterprises and banks carried over from socialism,[84] thus freeing the judicial bankruptcy procedure to deal with ailing firms in the newly emerging private sector.

Linked to the legal framework for bankruptcy is that of pre-bankruptcy debt collection, including the possibility for registering and foreclosing on collateral. The system of collateral in CSFR is underdeveloped both in law and in practice. Although lenders are in theory able to take mortgages on real property and register them in the land registry, this has not been a common means of securing loans, primarily because of the impossibility of evicting tenants or residents from housing combined with the availability in practice of other forms of security (such as garnishment of wages). With regard to moveable property, the Civil[85] and Commercial[86] Codes provide a legal basis for using such property as collateral, but because there is no central registry, there is no practical way--short of transfer of possession or title--to inform third parties about the claim and thus ensure priority. Providing viable means to mark property serving as collateral, or setting up a central registry for collateral interests in moveable property (as in the U.S.), would help increase the security of loans and improve debt collection.

Competition Law

Moving from a socialist to a market economy requires a profound change in the structure of the enterprise sector and in the climate and attitude towards competition. The private sector is still relatively small in CSFR, accounting for an estimated 8 percent of GDP and 16 percent of employment in 1991.[87] The economy continues to be dominated by the

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[83] See Gray, et.al., supra note 67, and Gray and Stiblar, "The Evolving Legal Framework for Private Sector Activity in Slovenia," World Bank WPS 893, April 1992.

[84] A systemic approach to simultaneous bank/enterprise restructuring is being considered, for example, in World Bank programs with Poland, Romania, and Slovenia.

[85] Civil Code, Para. 151a.

[86] Paragraphs 297-302.

[87] D. Swanson and L. Webster, "Private Sector Manufacturing in the Czech & Slovak Federal Republic: A Survey of Firms," draft report, August 18, 1992, p. 14.

public sector, primarily large public enterprises. Promoting competition in this environment will require strong and concerted action to break up public monopolies, privatize public firms, open any remaining barriers to foreign competition (both trade and investment), and prevent anticompetitive behavior or mergers among competing firms. Programs of privatization and trade liberalization are both progressing steadily and are topics outside the purview of this paper. Breaking up public monopolies and preventing anticompetitive behavior lie within the mandate of antimonopoly law.

The CSFR antimonopoly law, the Law on the Protection of Economic Competition,[88] was passed January 30th and took effect March 31, 1991. It follows closely German and EC law and is quite similar to the Polish antimonopoly law. It is concerned primarily with cartel agreements, mergers, and "dominant" behavior. With regard to cartel agreements, Section 3 prohibits agreements among entrepreneurs to set prices, limit production or sales, divide markets, "tie" purchases of certain products to purchases of other unrelated ones, discriminate against certain purchasers, or restrict others' access to markets. These prohibitions do not apply if the market share of the participants is less than 30 percent of the "relevant market." Section 4 then deals with licensing of intellectual property rights and prohibits licensing agreements that impose unrelated conditions on the transferee. However, Section 5 allows the Competition Office to exempt certain agreements from the prohibitions in Sections 3 and 4 for a set time upon request of the parties "as long as the restriction of competition ... is necessary for reasons of public interest, especially in the production of goods or in support for technological or economic development."

With regard to mergers, Section 8 requires prior approval from the Competition Office of merger agreements that would give the new firm a market share of over 30 percent. The office is to approve the merger if "the loss, which may occur due to the restriction of competition, will be outweighed by the economic benefits provided by the merger."

In line with European emphasis on "dominance," Section 9 requires any firm with at least a 30 percent market share to inform the Competition Office. It prohibits that firm from "abusing" that dominant status through unfair contract terms, "tied" sales, discrimination among purchasers, or monopolistic restriction in production, sales, or technological development.

In delineating the various types of anticompetitive behavior, the law does not distinguish between "horizontal" and "vertical" restraints, although antimonopoly theory in the U.S. and to some extent Europe tends to see horizontal restraints as the most egregious inhibitors of competition. Nor is there a clear distinction between behavior that is always illegal (the "per se" approach) and behavior that is illegal only under certain conditions (the "rule of reason" approach). In almost all cases (except perhaps Section 9) the approach

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[88] Law No. 63/1991.

appears to be "rule of reason," because the Office has almost unlimited discretion to grant exemptions from the prohibitions in the law.

Because of CSFR's federalist structure, the law set up not one but 3 Competition Offices--one in each republic and a federal one to deal with cases that affect at least 40 percent of the market in both republics.[89] The powers of the offices are broad. They can bring cases on their own initiative or on the request of an outside party, investigate and decide those cases, and impose fines or demand specific action to undo an identified wrongdoing.[90] Their decisions can be appealed to the court by any party within 30 days.[91] The existence of 3 offices has complicated the administration of the law, both because of the diminution in expertise among them and because of unavoidable confusion concerning their respective jurisdictions. The federal office was recently abolished in preparation for the country's split.

One positive aspect of the law is its linkage with the privatization program. Section 19 requires that the government analyze the market conditions likely to result from a privatization proposal and "to stipulate specific conditions which, when they are met, will terminate the monopolistic status of the former enterprise or will prevent the creation of the monopolistic status of newly created enterprises."[92] The analysis must be submitted to the relevant Competition Office for comment before a final decision is made on the privatization. This link is intended to help prevent public monopolies from becoming private ones.

As in Hungary and Poland, the impact of the CSFR antimonopoly law will depend on how it is applied in practice. Unfortunately, it is notoriously difficult--even in the advanced market economies--to distinguish a restraint of trade that harms efficiency from a legitimate business initiative that enhances it. Overzealous enforcement, particularly enforcement that specifically attempts to regulate prices, could do great harm by overruling reasonable business decisions and more generally inhibiting entrepreneurship throughout the economy. On the other hand, it is clear that certain types of highly restrictive monopolistic behavior--such as price fixing among competitors or aggressively freezing new competitors out of the market by refusing to deal with them--need to be stopped. Furthermore, the Competition Offices can fulfill a very valuable public service by being the "advocate" for competition, both by publicizing their own initiatives and decisions and by lobbying more generally for freer trade. Helping to change public attitudes and educate the public about the benefits of competition may be their most important mission at this time.

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[89] Section 10 (1).

[90] Section 11.

[91] Section 13 (2).

[92] Section 19 (1).

Judicial Institutions

As in other CEE countries, judicial institutions in the CSFR are ill-prepared to cope with the rapidly emerging challenges of a market economy. The plethora of new legislation in the past 2 years has bred many new types of disputes never before seen by this generation of judges and lawyers. In 1991, some 121,000 commercial cases were filed in the Czech Republic (48,000 in Prague alone) and some 60,000 in the Slovak Republic. That number is expected to jump significantly higher in 1992 as new restitution cases enter the courts and as the moratorium on bankruptcy claims is lifted.

A new law passed in late July, 1991--the Law on Judges and Courts--restructured the court system to help prepare it for its new role.[93] Courts in the CSFR are divided into 3 levels--the Supreme Court, 12 regional courts, and about 120 local courts. Each republic has its own Supreme Court, and there is one federal Supreme Court.[94] The Supreme Courts hear appeals from the district courts, while the district courts hear appeals from the local courts and are the courts of first instance for cases with over 50,000 Kcs. at issue. Pursuant to recent legislation, the Supreme Courts and the district courts each have 4 departments--for criminal, civil, administrative, and commercial[95] cases. Property and restitution cases are handled by the civil departments (which, together with criminal departments, were carried over from the previous system), while company and contract cases under the new Commercial Code are handled by the newly-established commercial departments.[96] As of January 1, 1992, the newly-established administration departments can handle citizen's complaints against civil servants once internal avenue of redress have been exhausted, thus potentially providing an important new avenue of protection against arbitrary government acts.

In addition to restructuring the court system, efforts have been made both to give existing and new judges greater independence[97] and to remove judges clearly compromised by the socialist regime. As a result of the purge, combined with the generally low pay and prestige of the profession and the growth of opportunities in private legal practice, there is now a serious shortage of judges. While demand skyrocketed, the number of judges actually

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[93] Law on Judges and Courts, July 19, 1991.

[94] The federal Supreme Court was designed to act as final arbiter between the republican courts, but it's continued existence is uncertain given the impending split-up of the federation.

[95] In 3 districts new commercial courts have been set up in lieu of specialized departments within the regular district courts.

[96] The latter are staffed primarily by former arbitrators from the recently-abolished state arbitration system that used to decide disputes among state enterprises.

[97] Judges generally have life tenure, but it is still possible to remove judges associated with the previous regime.

fell in the first two years after the 1989 revolution.[98] It will continue to be very difficult to staff the courts with competent and experienced judges. Incapacity in the court system is likely to be a constraint for some time to come.

Conclusion

Like its CEE neighbors, CSFR is moving rapidly to create a legal framework conducive to private sector development and the growth of a market economy. Real property rights are being redefined, and large amounts of property are being returned to former owners. Laws on intellectual property have been amended, in large part due to prodding from the U.S., to bring their levels of protection in line with that of the most advanced market economies. A new Commercial Code now lays out a thoroughly modern structure for companies (whether domestic or foreign) and for commercial contracts, but its simplicity appears somewhat compromised by continuing bureaucratic interference through other laws and regulations. A new competition law provides a reasonable framework for antimonopoly protection, while a new bankruptcy law provides at least the beginnings of a legal framework for the liquidation of nonviable enterprises.

Yet there are major challenges ahead to implement the new laws that are now on the books. The interests of former owners of property are clashing with those of current tenants, leading to a surge in new disputes now entering the courts. The surge in cases is likely to be exacerbated as the current moratorium on bankruptcy claims against state enterprises expires in early 1993 and as cases under the new intellectual property laws and commercial code come on stream. The courts, suffering from recent purges of judges compromised by the former regime as well as generally low pay and prestige, are unlikely to be able to handle this surge. The specialized offices handling intellectual property and antimonopoly concerns are also facing daunting challenges adjusting to the radical changes in policy and thinking now sweeping the country. Their areas of concern are complex, and they will need continuing resources to train their staff to understand the issues and keep up with the growing workload. All in all, it is a time of great progress, great confusion, and great challenge.

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[98] Before November 1989, there were some 1600 judges working in the Czech Republic. This number had fallen to 1300 by April 1991. J. Pehe, "Reforming the Judiciary," Report on Eastern Europe 2:34, August 23, 1991.

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